



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

CLOSE
NO PROTEST
REC'D

Date:

AUG 3 2001

Contact Person:

ID Number:

Telephone Number:

NO PROTEST RECEIVED

Release to Manager, EO Determinations - Cincinnati

DATE:

SUBNAME

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated pursuant to the Laws of the State of [redacted] on [redacted]. Your amended Articles of Incorporation provide that you are organized for charitable purposes within the meaning of Section 501(c)(3) of the Code. Your Initial Board of Directors includes [redacted] and [redacted] and [redacted] were your incorporators.

You were originally formed to develop and operate a [redacted] charter school and perform research activities. Since filing your Form 1023, you have modified your purpose and activities. You now describe yourself as a support organization incubating numerous schools throughout the country. You plan to develop charter schools around the country with the first "prototype" being developed in the [redacted] area. You plan to coordinate funds and organizational efforts for the development of charter schools and the delivery of exclusive teaching methodology and Personal Exploration Plans (PEP) to constituencies and learners in a variety of schools, home schools, and individual learning situations.

In regard to the development of charter school operations, you will manage the building and start-up costs, but once the charter is approved, charter schools will lease the facilities from you. The name of the anticipated, first prototype charter school will be [redacted] and it will be a public school in [redacted]. The charter school will operate on public education funds and donations, just as any other public school in the state.

You indicate that your role in the development of [redacted] charter schools may be slightly different from what will be provided to schools in other states due to [redacted]'s charter school statute. Your role with respect to the development of other charter schools is primarily one of providing technical assistance in the following areas: curriculum and educational methodology design and implementation, fundraising and grant-writing strategies, operations and facility set-up.

[REDACTED]

As schools become self-sufficient, you will move on to develop other schools, all based on the same principles and models, but governed locally. You will assist in the delivery of your unique educational methodology, Internet-based support serves and ongoing research and development, national level fundraising and lobbying, regular review of pertinent national, state and local educational initiatives, guidelines, law, statutes and issues affecting charter schools and other non-profit educational efforts.

You have indicated that early working documents used the term [REDACTED] as a generic descriptor. You have secured registered domain names effectively staking out the [REDACTED] virtual presence including the name [REDACTED]. On or about [REDACTED], [REDACTED] ("[REDACTED]"), a for-profit company was incorporated pursuant to the Laws of the State of [REDACTED] was the incorporator. Officers of [REDACTED] are [REDACTED], president and [REDACTED] as secretary/treasurer. This organization will provide educational information and resources via the Internet to parents and educators. Its product focuses on linking standardized assessments scores to state educational standards and resources that can enhance student knowledge and skills in various academic areas.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and includes lessening the burdens of government.

Rev. Rul. 72-369, 1972-2 C.B. 245 holds that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code. Providing managerial and consulting services on a regular basis for a fee is trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Rev. Rul. 71-529, 1971-2 C.B. 234 holds that a nonprofit organization that provides assistance in the

[REDACTED]

management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualifies for exemption under section 501(c)(3) of the Code. Membership in the organization is restricted to colleges and universities exempt under section 501(c)(3) of the Code. Its board of directors is composed of representatives of the member organizations. Each member has the right to an accounting of its pro rata share of the investment funds and may withdraw from participation upon thirty days' notice. The organization will not make its services available to anyone other than the exempt organizations controlling it. Most of the operating expenses of the organization, including the costs of the services of the investment counselors and the custodian banks, are paid for by grants from independent charitable organizations. The member organizations pay only a nominal fee for the services performed. These fees represent less than fifteen percent of the total costs of operation.

Rev. Rul. 69-528, 1969-2 C.B. 127 holds that an organization regularly carrying on an investment service business that would be unrelated trade or business if carried on by any of the exempt organizations on whose behalf it operates, is not exempt under section 501(a) of the Code. The organization was formed to provide investment services on a fee basis exclusively to organizations exempt from Federal income tax under section 501(c)(3) of the Code. It receives funds from the participating exempt organizations, invests in common stocks, reinvests income and realized appreciation, and upon request liquidates a participant's interest and distributes the proceeds to the participant. The organization is free from the control of the participants and has the absolute and uncontrolled discretion in (1) investment of the property, (2) sale of investments and reinvestment of the proceeds, (3) payment of taxes and liens, (4) distributions of income and principal or the addition of accumulated income to principal, and (5) dealing with the property and managing the funds as if it were absolute owner thereof. In addition, a participant's ownership interest in the property does not entitle such participant to the whole or any part of the property or the right to call for a partition, division, or accounting of the property.

Section 501(c)(3) of the Code sets forth two main tests for qualification for exempt status. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3). Your amended Articles of Incorporation include the limiting language as required by section 501(c)(3) of the Code and are sufficient for satisfaction of the organizational test.

You must, however, also satisfy the operational test. The regulations under section 501(c)(3) expand on the requirements for satisfaction of the operational test. The key requirement is that an organization be operated exclusively for one or more exempt purposes. To determine whether this test is satisfied, section 1.501(c)(3)-1(c)(1) of the regulations directs the Internal Revenue Service to determine if the organization engages primarily in activities that accomplish one or more exempt purposes. Based on the facts that you have provided in your application for recognition of exemption, we are not able to conclude that you are operated exclusively for one or more exempt purposes.

Your activities are or will be similar to those described in Rev. Rul. 72-369 and Rev. Rul. 69-528 and are contrasted from the situation in Rev. Rul. 71-529. You will provide services to multiple unrelated tax-exempt organizations for a fee. Your board of directors are not appointed or controlled by the exempt entities. Your fees will not be "substantially below cost." As was specifically discussed in Rev. Rul. 72-369, the provision of services to a tax-exempt entity on an at-cost basis is not in and of itself a charitable activity.

Your early development included in working documents the term [REDACTED]. The only reading of this term is that you contemplate the joint operation of you and [REDACTED]. Your activities include Internet-based support services - a service coincidentally offered by a related for-profit [REDACTED]. Your directors stand to benefit substantially from the operation of [REDACTED].

Because your activities do not serve a charitable purpose and serve to promote the private interests of members of your Board of Directors, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
Attn: [REDACTED]
T:EO:RA:T:4, Room 3L3
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4